Judgments of Osaka District Court, 26th Civil Division
Date of the Judgment: 2006.1.16
Case Number: 2004(Wa)No.10298

Title (Case):
A case wherein the plaintiff claimed damages for default of the license agreement concerning a patent and other right to manholes against the defendant, who argued that the license agreement was invalid in the first place due to the provision restricting the number of products that the defendant may produce, and the court dismissed the defendant's argument and accepted the plaintiff's claims

Summary of the Judgment:

The plaintiff was the holder of a patent and other right to manholes. The defendant had obtained a license from the plaintiff to use the patent and other right. Under the license agreement, both parties had agreed that (1) the agreement shall be effective for a period of one year (i.e. the agreement will be renewed every year), (2) while the number of products that the defendant is allowed to produce is restricted, the defendant is not liable to pay any royalties as long as it produces and sells the products within the resections, (3) if the defendant desires to sell a larger number of the products than the limit, the defendant shall request the plaintiff to produce the products for the excess while, upon such a request, the plaintiff shall supply the defendant with the requested number of products to which the defendant's brand has been attached (OEM production), and (4) the defendant shall give the plaintiff quarterly reports on the number of products that the defendant produced and sold in the quarter in question and shall also immediately notify the plaintiff if the defendant has reached the limit.

The defendant gave the plaintiff an untrue report on the number of the products that the defendants had produced under the license agreement for FY 2003 and produced and sold the produces in excess of the maximum number permitted by the plaintiff. Based on these grounds, the plaintiff claimed damages against the defendant as compensation for the defendant's default of the agreement, equivalent to the amount that would have been gained by the plaintiff if the defendant had requested the plaintiff to produce the products for the excess.

In response, while having admitted that it had violated the license agreement, the defendant argued that the agreement was invalid in the first place because its provision on quantitative restriction violated the Antimonopoly Act and was against public policy (The defendant's first argument). The argument of the defendant can be summarized as follows. When the municipalities in the north Kyushu region adopted as their standard the manholes produced under the plaintiff's patent and other right, the plaintiff promised to the municipalities that it would license other manhole producers to use the plaintiff's

patent and other right. When the plaintiff prepared a license agreement to be concluded with each manhole producer every year, the plaintiff estimated the number of manholes to be used by each of those municipalities in their public works projects and set aside a certain proportion of the estimated demand for itself and allocated the remaining demand to other manhole producers. This was how the plaintiff determined the maximum number of products that each of the producers was allowed to produce under the license agreement. Therefore, the quantitative restrictions on the number of products imposed in this way must be considered to be an unfair trade practice (dealing on Restrictive Terms) prohibited by Article 2, para.9, item 4 of the Antimonopoly Act and para.13 of the Designation of Unfair Trade Practices and also under an unreasonable restraint of trade prohibited by Article 3 of the said Act.

The defendant argued that it inevitably produced and sold the excess number of the products because the plaintiff ignored the defendant' s proposal for discussions to establish the appropriate OEM production system (the defendant' s second argument).

With regard to the defendant' s first argument, the court held, as a general rule, as follows: "Article 21 of the Antimonopoly Act… should not be interpreted as excluding from the application of the Act even abusive competition restricting acts conducted in the guise of the exercise of a patent right or any other right. Thus, in a case where a non-exclusive license agreement for a patent or any other right contains a provision designed to restrict the number of products that may be produced under the agreement, if such restrictions are regarded as a violation of the Antimonopoly Act and as being against public policy, such a provision shall be considered to be invalid." However, the court dismissed the defendant' s argument in this case by holding "specific circumstances surrounding the market need to be clarified in detail before deciding whether to invalidate the provision. However, no clarification has been made about the circumstances."

The court also dismissed the defendant' s second argument by holding as follows: "The obligation of OEM production will not arise until the defendant has sold such number of iron covers that exceeds the permitted limit. This is why the defendant was obliged to notify the plaintiff upon reaching the limit. Furthermore, the obligation of OEM production actually arises only when the defendant gives a specific order to the plaintiff. For this reason, the establishment of the OEM production system that the defendant requested was basically an issue that the plaintiff needs to solve internally in order to fulfill the OEM obligation. The plaintiff's failure to establish the system before the obligation actually arises does not immediately constitute a breach of the obligation to the defendant. Based on these grounds, even if the plaintiff has been unwilling to establish the OEM production system or to give its estimate promptly, which might have made the defendant feel anxious about the reliability of the OEM production system, the plaintiff cannot be considered to have failed to satisfy its obligation to produce the products on an OEM basis because the defendant has not given the plaintiff a notice of excess production or a specific order in this case."

The court also held that the amount of damage suffered by the plaintiff shall be calculated by "multiplying the profits per plaintiff's product by the number of products sold by the defendant in excess." Regarding the profits per plaintiff's product, the court presented its basic stance by saying that "the profits are usually calculated by deducting the cost required for production and sale of the product from the profits that could have been obtained. However, this calculation method cannot simply apply to this case because what must be calculated as the amount of damages are the profits that the plaintiff would have been able to gain if it had produced the said excess number of products on an OEM basis. Therefore, it would be appropriate to deduct only the cost that would have been additionally accrued as a result of the plaintiff's OEM production of the said excess number of products in addition to regular production." Then, the court, after considering the facts related to plaintiff's manufacturing operation and other facts, concluded that only the production cost may be deducted. Since the plaintiff was engaged in producing and selling manholes and other cast iron products as well as products other than cast iron products, the court opined that, "Since the plaintiff has produced many types of products from the same raw materials using the same manufacturing process, it is impossible to separate the manhole products from other cast iron products to calculate the production cost of the manhole products. Thus, it would be appropriate, unless otherwise proved, to assume that the gross margin of the manhole products is the same as the average gross margin of all of the cast iron products produced by the plaintiff by use of the same raw materials under the same production process." Regarding the plaintiff's burden to prove the profits per plaintiff's product, the court held that, "In general, the plaintiff is supposed to submit all of the financial records as evidence so that the defendant can check the validity of the plaintiff's claim about the sales price and the costs including the cost of goods sold or production cost that should be deducted from the sales price. In this litigation, however, it would be extremely inappropriate from the perspective of providing a relief to the right holder if the plaintiff is required to bear such burden of proving the amount of lost profits because the plaintiff would have to spend a significant amount of time and energy to prepare financial records for submission as evidence. First of all, the amount of financial records is enormous. The plaintiff carries out about 1.2 million transactions involving cast iron products every year. The amount of accounting documents that the plaintiff prepared for disclosure to the defendant covering the above-mentioned period of four months was enough to fill up seven cardboard boxes. Since some accounting documents include trade secrets that need not be disclosed to prove the lost profits, such as information on the suppliers of the raw materials for production, if those documents are required to be submitted as evidence, the plaintiff needs to appropriately organize those documents and mask such parts of those documents that contain trade secrets." "On the other hand, it remains necessary to provide the defendant with an opportunity to check whether the sales and production cost claimed by the plaintiff are supported by the accounting documents. However, the defendant is expected to conduct such checking mostly by confirming whether the amounts claimed by the plaintiff are the same as those recorded in the accounting documents and also whether the amounts such as the sales claimed by the plaintiff may be derived from the figures recorded in the documents." "Based on these grounds, in a case like this one, the plaintiff should be considered to fulfill the obligation to prove its lost profits when the plaintiff gives the defendant an out-of-court opportunity to inspect the relevant accounting documents and undergoes the defendant's inspection instead of submitting the accounting documents to the court as evidence to support its claims. If the defendant refuses to inspect the documents without any legitimate reasons or if the defendant finds no contradiction between the amounts claimed by the plaintiff and the amounts recorded in those accounting documents, the plaintiff should be considered to have satisfied the obligation to prove its claims. If the defendant still opposes the figures claimed by the plaintiff, the defendant should be required to present legitimate reasons for the opposition." By saying so, the court presented specific guidelines for the defendant's inspection. As the defendant refused to conduct such inspection despite the plaintiff's proposal, the court took such reaction itself as the argument of the defendant and accepted the amounts claimed by the plaintiff.